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Underwriting Trends

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Volume 20 Number 1 March 2008

Message from the Chairman

by J. Brian Murphy, CPCU, ARM, ARe, AMIM

J. Brian Murphy, CPCU, ARM, ARe, AMIM, is vice president of reinsurance for Brokers' Risk Placement Service, a managing general underwriter and reinsurance intermediary located in Chicago. His responsibilities include the marketing and placement of reinsurance for commercial clients. His experience includes underwriting roles in two of the largest commercial insurers spanning more than 25 years, and recently on the brokerage side of the business.

Murphy received his bachelor of arts degree from Central Connecticut State University, and his master of arts from the University of Connecticut, both in economics. He frequently teaches the Insurance Institute of America's General Insurance (INS) course to new members of the insurance community. He serves on the board of the Association of Lloyd's Brokers, which provides information, education, and business contacts to Lloyd's correspondents and coverholders in Illinois.

He also serves on the board of the Elmhurst City Centre in Elmhurst, IL; is a director of the CPCU Society's Chicago Chapter; and is the new chairman of the CPCU Society's Underwriting Interest Group Committee.

A Reflection on the New Year

In the last issue of *Underwriting Trends*, my message reflected on our accomplishments in 2007. While we are still fresh from welcoming in 2008, it seems appropriate to reflect on some things currently in store for this new year.

First, the Underwriting Interest Group Committee will be meeting April 5 during the mid-year Leadership Summit to discuss seminars for the 2008 CPCU Society Annual Meeting and Seminars. We plan to host a seminar at the Annual Meeting on construction wrap-ups. As usual, we will be providing well-known industry experts as guest speakers on this topic. We will also offer a luncheon at the Annual Meeting with a qualified speaker on the topic of emerging issues. Please stay tuned to future publications with more information on these Annual Meeting and Seminar events.

Speaking of the 2008 CPCU Society Annual Meeting and Seminars, I am sure you are aware that it will be held September 6–9 in beautiful Philadelphia, PA. The theme this year is CPCU: Heritage & Horizons. Be sure to watch for details in upcoming issues of *CPCU News* and *e-LINK*, and on the Society's web site.

Second, our plans are to continue to provide you with excellent articles throughout the year in our *Underwriting Trends*. It is our goal to publish information that will be of great value to you on topics that are of significant importance in the underwriting industry. As always, we welcome any suggestions you may have on topics we can research on your behalf and make available in one of our publications. If you would like to serve on a CPCU Society committee or task force, and/or write articles for the *Underwriting Trends*, do not hesitate to let me know.

As you read the articles provided in this issue, we trust you will find them both educational and helpful. On behalf of the Underwriting Interest Group, I wish everyone a prosperous new year. We look forward to hearing from you soon.

What's In This Issue

Products Liability in Mergers and Acquisitions

by Susan Kearney, CPCU, ARM, AAI

■ **Susan Kearney, CPCU, ARM, AAI,** is senior director of knowledge resources at the American Institute for CPCU and Insurance Institute of America (the Institutes) in Malvern, Pennsylvania.

Author's note: This article is based on material published by the Institutes' independent, not-for-profit organizations offering educational programs, professional certification, and research to people who practice or have an interest in risk management and/or property/casualty insurance. The material in this article is covered in the Chartered Property Casualty Underwriter (CPCU®) designation program and the Associate in Commercial Underwriting (AU) designation program, which are among the Institutes' numerous educational offerings.

Potential products liability issues continue to turn up in front-page headlines of today's news stories—from lead paint in toys, and recall of child safety seats, to E. coli bacteria in ground beef, and harmful side effects of a prescription drug. Consumer demand for safer products has led to increased litigation, and large judgments against negligent manufacturers have captured businesses' attention.

Products liability, a rapidly expanding area of tort law, is a manufacturer's or seller's tort liability for harm suffered by a buyer, user, or bystander as a result of a defective product. For years after a product is sold, manufacturers, wholesalers, distributors, and retailers may face products liability claims and lawsuits. Products liability lawsuits may involve both liability for harm caused by the product, and liability for harm resulting from a service or process.

With companies growing worldwide by mergers and acquisitions, rules governing the liability of a successor corporation for the obligations of its predecessor can create unforeseen product liability exposures and accompanying insurance issues. Many times these are often overlooked by the successor corporation, and can prove to be financially devastating.

In a corporate merger, the surviving corporation owns all of the disappearing corporation's assets and is subject to its liabilities. However, the most complex cases of successor liability involve the purchase of assets rather than an entire company. When a business buys all or most of the assets of another, it may leave injured consumers no recourse for injury caused by defective products.

The general rule, which is a judicial rule not a legislative rule, is that a successor that purchases only the assets of a predecessor assumes none of its liability. The courts recognize this as the principle of successor non-liability. There are, however, four very important exceptions:

- The purchaser expressly agrees to assume the seller's liabilities.
- The purchase is a de facto merger or consolidation.
- The purchase is a fraudulent conveyance as a means to avoid the predecessor's obligations.
- The successor is a mere continuation of the predecessor.

Most case law centers on the fourth exception, and the court will likely impose liability on the buyer for torts of the seller that occurred before the sale if the following occur:

- A single buyer acquires substantially all of the predecessor's assets.
- The seller agreed to dissolve as soon as practical after the sale.
- The purchaser presents itself to the public as the predecessor or a continuation of the predecessor.

While a simple solution for the successor company would be to acquire the rights under the predecessor's insurance policies, most insurance policies bar assignment or change in control. Even with insurer consent or courts granting coverage under the predecessor's policies irrespective of a "no assignment" clause, these policies may either lack adequate limits and coverages or lack sufficient evidence or proof of coverage. This often leaves the surviving company to face liabilities with little to no benefits of the acquired company's insurance policies.

From an insurance company perspective, the possibility exists for the newly organized entity to have significant exposures not contemplated in the underwriting and pricing of the account. Whenever mergers and acquisitions take place, the underwriter must determine the contractual arrangements in place relative to the liabilities for prior products. The account should supply this information as an opinion from its own attorney. The underwriter may also request that the insurer's attorney review the information supplied by the account.

It is essential for the underwriter to know whether the successor account can be held liable for products sold before the acquisition, merger, or consolidation so that the insurance company knows what it is insuring. Without evidence of a well-drafted agreement and proper due diligence, the carrier may exclude, limit, or charge an exorbitant price for coverage to protect the successor company from potentially inheriting financially crippling claims.

Managing products liability issues in mergers and acquisitions can pose significant challenges. It is imperative for a company to uncover possible unknown successor liabilities through the due diligence process prior to a merger or acquisition. This should include an in-depth risk management analysis along with a solid buy-sell agreement that clearly states each party's responsibilities. A thorough due diligence and risk management analysis can assist the successor company in identifying, evaluating, and properly addressing those exposures and potential issues to avoid or minimize its future liability. Many times these issues are not addressed until after the deal has been finalized—at which time it's too late. ■

New Regulatory Challenges for Property and Casualty Insurance Company Independent Board of Directors

by Andrew J. Barile, CPCU

Andrew J. Barile, CPCU, is an independent director of insurance companies having had more than 40 years of insurance and reinsurance industry experience, as an executive of managing general agency, insurance company, reinsurance broker, and reinsurance company. He is a CPCU, and an active member of the CPCU Society and the following CPCU Society Interest Groups: Agent & Broker, Reinsurance, Regulatory & Legislative, Risk Management, Underwriting, and Excess/Surplus/Specialty Lines.

Recent developments in the property and casualty insurance company board of directors has shown that hedge funds, private equity firms, and other institutional investors like pension plans are finally looking at the concept of putting their own director on the board of the insurance company. Ownership of more than 5 percent of the insurance company's stock should require board representation. Some principals of private equity firms (even though inexperienced in the insurance industry) are getting board positions. It remains to been seen how active they can be in challenging chief executive decisions when they have no experience in the insurance and reinsurance industry.

Insurance regulators, in recent examinations of property and casualty insurance companies, are playing a more active role when meeting with the board of directors. Outside independent directors should be insurance experienced and have three-year board positions. Churning boards of directors are not looked upon favorably by state insurance departments; continuity makes for a better, more active board of directors.

Let us examine what types of questions are likely to be asked and discussed, all in the interests of having a meaningful insurance company board. These questions are designed for the boards of the privately owned insurance company, not publicly owned insurance companies.

1. Overview of the board of directors:
   - Experience and background of the chairperson.
   - Explain the duties and critical roles.
   - Summarize the formal committee structure and reporting requirements to the board of directors.
   - Explain the training, assessment, and qualifications of each board member.
   - Explain the relationship, communication frequency among the board, executive management, and internal/external auditors.

2. Utilization of enterprise risk management from the board of directors' perspective:
   - Explain the role of the board of directors in strategic planning, enterprise risk management, and corporate governance.
   - Discuss and outline the role of the board in establishing and monitoring internal controls.
   - Describe the most significant risks and how they are being managed.

3. Management information from the board of directors' perspective:
   - What are the reports utilized to make key business decisions?
   - Describe the strategy for corporation succession. What is the current plan in place?
   - Rewarding management performance. What types of compensation structures are utilized by the board of directors to monitor and reward management performance?

4. The political/regulatory environment from the board of directors' perspective:
   - Describe the top areas of concern in the upcoming year and how are they being managed?
   - How does the board of directors identify and manage changes in business conditions?

5. What are the advantages/disadvantages of the insurance company from the board of directors' perspective?
   - Can you capitalize on strengths?
   - What are the biggest threats to the insurance company? What keeps you up at night?

Independent directors need to be kept informed and be active participants at the board level. Drawing from their insurance experience is always helpful whether it be dealing with private investors, regulatory officials, rating organizations, reinsurance brokers, reinsurance companies, insurance retail, wholesale, and managing general agents, and third-party claims administrators. ■

Oil Heat Retailers Reach Out to Insurance Industry

Industry Organizations Separate Fact from Fiction Regarding Home Fuel Tanks

by Steve Goldberg, CPCU, FCAS, MAAA

Steve Goldberg, CPCU, FCAS, MAAA, is executive vice president of Benfield, the world's leading independent reinsurance and risk intermediary. NORA engaged Benfield as a consultant to help it establish a dialogue with the insurance industry. Goldberg can be reached at steve.goldberg@us.benfieldgroup.com.

Author's note: The information provided herein is intended for general information purposes only and should not be construed as advice or opinions on any specific facts or circumstances. The content of this article is made available on an "as is" basis, without warranty of any kind. Benfield disclaims any legal liability to any person or organization for loss or damage caused by or resulting from any reliance placed on that content.

In 2004, in the midst of the residential real estate boom, many nearly complete sales contracts collapsed when prospective buyers were unable to obtain homeowners insurance. The problem wasn't lack of funds or poor credit. The problem was oil heat.

Insurers feared that fuel oil leaking from home storage tanks had the potential of resulting in costly third-party and environmental liability claims. And even though the oil heat industry had already developed new storage tank technology, testing procedures, and maintenance programs, insurers were still routinely refusing to write homeowners policies on homes heated with oil.

Faced with diminishing market share, The National Oilheat Research Alliance (NORA), a research and marketing association of home heating oil retailers, realized a nationwide education program was warranted.

Based on informal discussions with insurers, NORA realized that agents and underwriters had only a cursory understanding of oil heat storage. As a result, insurers were refusing to write homeowners policies solely on the basis of whether or not a home was heated with oil. Often insurers were not even making a distinction between underground tanks or above-ground tanks, nor did they have any knowledge of the latest storage tank technology.

Meanwhile, NORA accepted its own share of responsibility. For years, oil heat retailers had not been sufficiently proactive in their efforts to replace older technology as well as educating employees on ways to reduce the likelihood of leaks, which could lead to insurance claims. NORA's leadership understood they needed to better understand how insurers looked at oil heat, correct negative perceptions, and present the latest in safe and reliable oil heat storage technology.

NORA's immediate tasks were to demonstrate that the vast majority of homes heated with oil were good risks while educating insurers about the characteristics of those few homes that could pose a risk. Indeed, well-informed insurers who understood the risks had the potential of a competitive advantage when writing new policies. In addition, NORA wanted to explain innovations in tank technology and inspection regimens that could help mitigate the likelihood of leaks.

NORA reached out to the Institute for Business and Home Safety (IBHS) as the ideal insurance industry group to serve as a clearinghouse for information on oil heat fuel storage. IBHS' mission is to: "Reduce the social and economic effects of natural disasters and other property losses by conducting research and advocating improved construction, maintenance and preparation practices."

Between 2004 and 2007, under the auspices of the IBHS, insurers met with representatives of NORA to learn about the latest in oil heat storage technology and environmental safety advances. Based on those meetings with insurers, NORA and IBHS developed the "Roadmap for Good Practices" program built on three pillars: Release Prevention, Release Detection, and Corrective Action. The program is supported by a host of informational materials including instructional videos, PowerPoint presentations, check-off lists, on-site instructional classes, and databases of certified tank inspectors.

At last year's IBHS Annual Conference, NORA presented a workshop on mitigating insurance losses and a case study about how one large insurer had successfully utilized the information. The workshop also covered state trust funds, new technology, new inspection

procedures, and appropriate remedial response.

Since then, the IBHS and NORA have developed a "Top 10 list of Oil Heat Facts" for agents, underwriters, and other insurance industry professionals:

1. New underground storage tanks come with proven track records and 30-year warranties. The two most commonly used heating oil tanks today are the steel "sti-P3" tanks and fiberglass tanks.

2. There is a simple, inexpensive test to check the integrity of underground storage tanks. The new "static tank test" for underground tanks is 95 percent accurate in discovering small releases, and produces only a 5 percent false alarm rate. This test can be performed inexpensively on large numbers of tanks in a short period of time.

3. New and improved oil lines that carry fuel from the tank to the oil burner have been developed. These new oil lines, sleeved in a polyethylene coating, protect the copper lines from damage and corrosion thereby helping to prevent releases.

4. Working closely with the IBHS, NORA has developed three distinct levels of inspection for home heating oil tanks. By inspecting tanks on a regular basis, the number and severity of claims will be greatly reduced.

5. Above-ground tank manufacturers have introduced several new corrosion-resistant tanks with extended warranties that greatly reduce the risk of failure. Among these are:
   - polyethylene/steel
   - double bottom polyethylene coated steel
   - fiberglass tanks

   "Secondary containment" devices are available for above-ground tanks, which can contain 110 percent of tank capacity in the event of a leak. Marketed as "tank tubs" or "tank basins," secondary containment is available for both indoor and outdoor installations. In the event of a release, these enclosures contain the oil and prevent it from causing damage to the home or property.

6. NORA has established tank education and certification programs to educate the oil heat industry about the proper installation and maintenance of tanks. The new technology is just the first step in reducing oil releases. To ensure that the industry does all it can do to prevent oil spills, NORA has published a manual and developed an education program for technicians on how to install, inspect, and service tanks in a manner that reduces the chances of oil releases. To date, some 1,500 technicians have been certified with NORA's Advanced Tank Degree.

7. NORA has created a national database of companies whose employees have been certified. Now some 300 companies in 13 states employ technicians who have earned NORA's advanced tank degree. To help homeowners and insurance companies locate qualified technicians to inspect and maintain their tanks, NORA has created a database which can be accessed at www.noraed.org.

8. NORA has funded research to add leak-detection capabilities to standard oil burner control systems. When fully integrated, these new controls will be able to provide an early warning in the event of an oil release.

9. NORA and IBHS have developed a primer that explains how the oil heat industry operates. The NORA/IBHS primer explains common oil heat industry practices, explores issues facing the oil heat and insurance industries, introduces modern tank technologies, and explores ways to prevent, remediate, and pay for claims. (For a free copy of the primer please contact info@nora-oilheat.org.)

10. Several states have established funds that help pay for the costs of cleanups. These funds are designed to be accessed by homeowners and cleanup specialists to substantially reduce the burden of remedial action after a release. At this time the following states have funds:
    - Maine
    - Maryland
    - New Hampshire
    - Nevada
    - North Carolina
    - Pennsylvania
    - Virginia
    - Vermont
    - Washington
    - Wisconsin

NORA has prepared a CD that includes data regarding each fund. (Contact info@nora-oilheat.org.)

NORA is deeply indebted to the IBHS for facilitating the ongoing dialog between insurers and the home heating oil industry. Ultimately it is the public that benefits most from the spirit of cooperation between these industries. ■

The Future Used To Be Certain

A Summary of Key 2007 Federal Legislation and Possible Impacts on Future Property and Casualty Operations

by Jody M. Pucel, J.D.

Jody M. Pucel, J.D., is a government relations and regulatory compliance attorney in Seattle, Washington. She received her law degree from DePaul University in Chicago, Illinois. After graduation, she worked as a law clerk for the Illinois Appellate Court before entering private practice in Chicago. She then joined the Corporate Legal Department of the Safeco Insurance Companies in 1992, most recently as senior legislative counsel. Her property and casualty insurance background includes expertise in legislative strategy and analysis; environmental issues; personal property insurance; commercial insurance; intellectual property; e-commerce; claims management; and regulatory compliance.

Author's note: The views expressed in this article are the personal views of the author alone and should not be considered in any way to represent the views of any entity.

Editor's note: This article originally appeared in the CPCU Society's Excess/Surplus/Specialty Lines Interest Group newsletter, *The Specialist*.

Property and casualty insurers have enjoyed some certainty that they could expect the usual legislative battles each year: opposing credit ban bills and auto body shop anti-steering initiatives while pursuing the often elusive tort reform measures and commercial lines deregulation legislation. The results of these battles, wins in some states and defeats in others, were generally balanced so that there was minimal disruption in overall market conditions, at least from a multi-state point of view. And federal legislation specific to the property and casualty industry was usually absent since there is no federal agency charged with regulation or oversight of the property and casualty insurance industry as a whole, other than through implementation of the Terrorism Risk Insurance Act of 2002 (TRIA). The pace and regularity with which state legislative agendas and results progressed and the limited federal legislative issues gave insurers some certainty about future operating environments. This future, however, is no longer so certain.

The 2007 Congressional legislative session, in contrast to prior federal legislative sessions, not only included no less than 14 specific property and casualty bills, but the insurance industry actively supported some of the bills. This support was in stark contrast to past years when the industry resisted federal legislation, preferring instead to rely on state laws and state oversight to manage the business of insurance. Pressure from global competition, improved technology, and unprecedented catastrophic losses (both natural and man-made) are changing the property and casualty insurance marketplace, prompting the property and casualty industry to pursue limited federal involvement.

Analysis of individual pending federal legislation indicates that some bills promote development of a free market while others might result in more government interference, making it easy to conclude that the industry should support the former and oppose the latter, as indeed the industry is doing. There is no assurance, however, that only favorable legislation will be enacted. Rather, it is possible that a combination of bills or pieces of different bills could be enacted, resulting in fragmented federal laws that not only might be dramatically different from current state regulations but would impact the industry nationwide, rather than in just a limited geographic area.

Legislation actively supported by the property and casualty insurance industry in 2007 included the Terrorism Risk Insurance Revision and Extension Act, which creates a federal financial backstop for commercial losses arising from terrorism events, allowing insurers to spread these risks across state markets and share the losses with the federal government; the Optional Federal Charter, which creates one license allowing insurers to do business in all states and opens the door to more foreign competition; and the Nonadmitted and Reinsurance Reform Act to simplify this market. Individually, these bills are expected to foster development of a healthier, competitive national market than now exists under the current multi-state regulatory structure.

On the other hand, there were also bills pending that would allow direct federal involvement in the insurance market,

raising concerns about unnecessary federal interference. The bills giving rise to these concerns include: the Multiple Peril Insurance Act, which would amend the National Flood Insurance Program to include wind losses; creation of a federal commission on natural catastrophes; and McCarran-Ferguson Anti-Trust repeal bills. The industry has expressed concerns that the multi-peril and catastrophe bills will allow the federal government to write property coverage in markets considered viable by insurance companies and in direct competition with the private market. The proposed repeal of the insurance anti-trust exemption raises concerns about costly and extended federal litigation challenging established industry practices, possibly disrupting the business of insurance.

As the 2007 federal Congressional session came to a close, Congress did enact the TRIA Extension, which was signed by the President at the end of December 2007. This bill reauthorizes the existing TRIA law for seven additional years without adding nuclear, biological, chemical, or radiological events into the current federal backstop program.

As we head into 2008, there is a distinct possibility that Congress will enact legislation creating a federal commission to study the property insurance market as it relates to natural catastrophes. On the other hand, it does not appear likely that either the Optional Federal Charter or expansion of the national flood program to include wind will pass in 2008, although a significant hurricane or other catastrophic event could change this outlook. Likewise, there has been no activity on the McCarran repeal legislation since April 2007 so it appears there is insufficient support to pass the bill.

Whether federal oversight of property markets can be limited to terrorism is not certain. Nor is it certain whether Congress fully appreciates the benefits of a limited federal role in regulating insurers under the Optional Federal Charter. What is certain is that the 2007 Congressional session did not include the usual legislative battles. And if this Congressional session is any indication, efforts to expand federal involvement will only continue in 2008 and beyond, quite possibly resulting in federal regulation of a complex industry facing increased global competition; and with an obsolete, 50-state patchwork of state regulation as the only basis upon which to develop national laws, making for an uncertain operating environment. As the industry contemplates its future, Congress could provide the property and casualty industry with some certainty by indicating an understanding that there is ultimately one U.S. property and casualty insurance market; the future operating environment for this market not only depends on which individual bills are enacted but also on how all the bills enacted fit together in the aggregate; and, unlike a single state law or regulation that impacts operations in only that state, a single federal law will impact all operations immediately and on a nationwide basis.

Details of Key 2007 Property and Casualty Federal Legislation

1. **Terrorism Risk Insurance Revision and Extension Act (TRIREA), HR 2761**

   Signed by the President on December 27, 2007.

   Extends existing TRIA law for seven years, through December 31, 2014. Applies to losses due to domestic or foreign terrorism events. Is applicable to only specified commercial products. Insurers are required to make coverage available for these losses and to retain a portion of risk through program deductibles. The insurers and federal government also share in the losses above the deductible, up to $100 billion.

   Federal involvement is limited to providing financial certainty to insureds and insurers for losses due to terrorism events, thereby creating a market in which insurers can compete in terms of price and coverage while sharing in the risk with the federal government.

2. **Optional Federal Charter (National Insurance Act), S.40, HR.3200**

   These companion bills would establish a dual regulatory structure, similar to the banking and securities structure, by creating a separate federal regulatory system for insurers choosing to operate under a federal license. This federal system is designed to pre-empt state regulation other than state unclaimed property and escheat laws, tax laws, assigned risk plans, mandatory residual market mechanisms, compulsory coverage requirements for workers compensation or motor vehicle insurance, participation in advisory or statistical organizations, and participation in a workers compensation administration mechanism. The federal regulator would have authority to oversee financial standards; product maintenance; unfair practices in sales, marketing, and claims handling; acquisitions and mergers; licensing; holding company issues; and insolvencies.

   A federal regulatory system is expected to result in a competitive market free of artificial rate and form restrictions as well as a consistent regulatory environment in which to do business in all 50 states. By

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The Future Used To Be Certain

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providing for a single regulatory system, the OFC would remove some of the more onerous trade barriers faced by offshore insurers wanting to do business in the United States.

3. **Nonadmitted and Reinsurance Reform Act of 2007, HR 1065, S 929**

   Originally introduced in 2006 and passed by the House, this re-introduced version would provide a uniform system of surplus lines premium taxation, elimination of duplicative compliance requirements for multi-state surplus lines transactions, and direct access to the surplus lines market for large commercial insurance buyers. The bill would also allow ceding insurers and reinsurers to resolve disputes pursuant to contractual arbitration clauses.

   This bill would simplify and streamline the often conflicting regulations among the 50 states and bring more certainty to the insurance market.

4. **Multi-Peril Insurance Act, HR 3121**

   This bill purports to solve the perceived problem that wind coverage is unavailable and/or unaffordable in hurricane-prone areas by expanding the National Flood Insurance Program to provide coverage for hurricane-related property losses.

   In effect, the NFIP would not only directly compete with the insurance industry in this market segment but it would have a competitive advantage over the industry by being able to offer the coverage for lower premiums than what the private market could charge under existing state regulations.

5. **Federal Commission on Natural Catastrophe Risk Management and Insurance, S. 292, and HR 537**

   The proposed Commission would study the affordability and availability of property insurance in the private market, focusing on the need for federal management of natural catastrophe risks and insurance.

   The industry position is that a healthy, competitive private market will result in available and affordable coverage. Therefore, federal management of the risk, including rates and coverage, equates to unnecessary interference in the private market and in the business of insurance would obstruct parallel efforts to enact true market reform legislation.

6. **The Insurance Industry Competition Act of 2007, S.618, HR 1081**

   These bills would amend the McCarran-Ferguson Act by repealing the insurance industry's exemption from federal anti-trust laws. Currently, the exemption requires federal anti-trust enforcement agencies to refrain from enforcing anti-trust laws against the insurance industry's collective activities, such as those involving sharing data for rate development and using standardized forms, but only to the extent that the collective activity is subject to adequate state regulation.

   Repealing the exemption would give the FTC "gap-filling" authority to regulate insurance companies where state laws do not exist or are deemed insufficient, and federal anti-trust laws would apply to all insurance practices. Since the FTC would have to promulgate regulations, established state-sanctioned activities would continue to operate but would now be subject to legal challenges under the "state action" doctrine under which state laws are reviewed to determine whether they adequately ensure an anti-competitive market. Also, insurers' collective activities would be subject to direct anti-trust litigation. It would likely take years for the federal government to implement gap-filling regulations and for anti-trust litigation to resolve into settled business parameters. In the interim, state regulatory schemes would be under judicial scrutiny, insurer collective activities would be subject to federal anti-trust litigation, and litigation and compliance expenses would increase, resulting in an uncertain market in which to do business. ■

Have You Considered Volunteer Leadership Opportunities?

The CPCU Society membership is what makes the CPCU Society one of the most thriving and successful organizations in the industry today. As a member of the CPCU Society and your local chapter, you'll find many opportunities to contribute to the success of the Society—while developing your leadership skills and giving something back to the industry.

How can you get involved?

- At the local chapter level by:
  - Serving on a chapter committee or task force.
  - Step up and express interest in becoming an officer or chapter leader.
  - Volunteer to coordinate a chapter Good Works project, such as a joint event with a community organization.
- At the Society level by (filling out an Application for CPCU Society Service):
  - Apply to serve on a task force.
  - Reach out to an Interest Group Committee and inquire about possible opportunities to become a committee member.

Interest Group Committee involvement offers unique one-of-a kind networking, learning, and fellowship opportunities that can translate into career advancement and allow you to give something back to the organization and industry.

For more information, contact the CPCU Society at (800) 932-2728, option 4. ■

Get Exposed!

We're always looking for quality article content for the Underwriting Interest Group newsletter. If you, or someone you know, has knowledge in a given insurance area that could be shared with other insurance professionals, we're interested in talking with you. Don't worry about not being a journalism major; we have folks who can arrange and edit the content to "publication-ready" status. Here are some benefits of being a contributing writer to the Underwriting Interest Group newsletter:

- Share knowledge with other insurance professionals.
- Gain exposure as a thought leader or authority on a given subject.
- Expand your networking base.
- Overall career development.

To jump on this opportunity, please e-mail either Stephen W. White, CPCU, at steve.white.bnbg@statefarm.com or Gregory J. Massey, CPCU, CIC, CRM, ARM, PMP, at greg.massey@selective.com.

Risk Management for Insurers: Risk Control, Economic Capital and Solvency II

by Rachel Thompson

■ **Rachel Thompson** is senior manager, Research and Markets Ltd.

The insurance industry is facing turbulent times and risk management is at the top of the agenda. This is particularly the case in Europe, where the introduction of Solvency II will drastically redesign the supervisory rules for regulatory capital for insurance companies. Therefore it is crucial that the industry fully understands how to implement risk management best practice.

Solvency II is reaching a final phase and pressure is mounting on insurers to implement and professionalize risk management practices. Needless to say, supervisors are encouraging risk management information to be more widely spread throughout organizations in order for it to be fully integrated into the day-to-day management of the business. Many companies are at this moment upgrading their risk management systems.

In this timely new book, industry expert René Doff argues that Solvency II, which aims to improve standards of risk assessment, should be regarded as an opportunity. Solvency II will provide incentives for insurance companies to improve their risk management systems and will allow you to benefit from the risk management efforts in the context of supervision.

Risk management and value creation are inherently tied together. This book also shows how to integrate risk and value management into the management control framework of insurance companies. It highlights the evolution of embedded value into market consistent techniques and fair value. These issues are also relevant in the context of accounting regulation (IFRS).

This new user-friendly book will help you to quickly get to grips with risk management terms and techniques and how they relate specifically to the insurance industry. It also demonstrates how Solvency II is already shaping the regulatory agenda and its likely impact on the insurance industry.

Risk Management for Insurers is an accessible reference for the whole insurance industry, identifying and discussing how to measure and manage seven major risk types:

- market risk, including interest rate and equity risk
- credit risk
- liquidity risk
- non-life risk
- life risk
- operational risk
- business risk

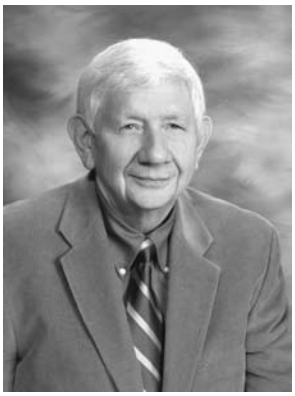
The main benefit of *Risk Management for Insurers* is that it emphasizes the practical risk management concepts, rather than technical calculations and detailed theory, making it easier for a layman to understand. What's more, all concepts and terms are applied to clear illustrative examples and the regulation and supervision developments are simple to follow.

As it is becoming increasingly important to interpret and incorporate the economic capital outcomes of all the risk models discussed, the book also focuses on the terminology and methods for calculating economic capital and fair value. It is recommended for risk managers, actuaries, controllers, accountants, auditors, corporate finance managers, underwriting and reinsurance managers, investment managers, equity analysts, and financial consultants.

For a complete overview of this report, go to http://www.researchandmarkets.com/product/e5f75d/risk_management_for_insurers_risk_control. ■

Q&A with Donald S. Malecki, CPCU

by Donald S. Malecki, CPCU



Donald S. Malecki, CPCU, is a principal at Malecki Deimling Nielander & Associates L.L.C., based in Erlanger, KY. During his 45-year career, he has worked as a broker, consultant, archivist-historian, teacher, underwriter, and insurance company claims consultant; and as publisher of *Malecki on Insurance,* a highly regarded monthly newsletter.

Editor's note: This article originally appeared in the November 2007 issue of *Consulting, Litigation, and Expert Witness Interest Group Quarterly*.

We have noticed for a long time now that some construction contracts written by owners of projects require contractors to not only name the owners as additional insureds but also to cover the owner's officers, directors, and employees. When the owner is a partner or joint venture, the contract requires not only the partnership to be covered but also its partners and employees.

While some insurers may accommodate their contractor insureds and fulfill those requirements, we think it would be the exception rather than the rule. What we are wondering is whether you are aware of any cases that have been litigated over a contractor's failure to obtain additional insured status covering all the persons specified in the contract, and your opinion over the practice of promising coverage that is not delivered.

For as often as these contractual requirements have been made, and as frequent as additional insured court cases are, one would expect to see arguments over a contractor's breach of contract for failing to obtain the additional insured coverage for an entity (corporation or partnership) and its officers, directors, and employees. (Some contracts may even require coverage for an entity's agents.) Yet, there are no cases on this point, or if there are, they are very few in number.

Probably the reason for a dearth of these cases is that when a suit is filed, the plaintiff generally looks for the "deep pocket," which, in most cases, is the entity, rather than its executives, employees, and agents. An executive or employee could conceivably be singled out when his or her conduct was egregious enough to prompt being named, but these cases are not known to exist.

Why a contractor or anyone for that matter would agree to add all of those persons as additional insureds is difficult to answer. Contractors may be under the assumption that additional insured status encompasses everyone. They may not care what the contract states so long as they are awarded the job. They can worry about problems later, if they should arise. There is also the possibility that contractors, and others who must agree to add others as additional insureds, are confused. After all executive officers and employees are commonly considered insureds under an entity's liability policy, why not also under an additional insured endorsement?

It does not take a rocket scientist to figure out that question; an additional insured endorsement does not commonly cover an entity's executives (partnership or corporation) and employees. Most additional insured endorsements describe the entity considered to be an additional insured and nothing more.

Today, more so than ever before, additional insured requirements must be in writing and with a copy of the endorsement accompanying a certificate of insurance. If the entity requiring additional insured status for itself and its executives and employees does not check the endorsement and reject it where coverage falls short of the requirements, there is a chance that if a dispute arises, at the time of claim or suit, a court could consider that requirement waived.

The basis for this statement—which by no means is this writer's opinion—is that some courts have ruled that when a noncomplying insurance certificate is not questioned until after a claim is made, the requirements that were to be reflected in the certificate are considered waived. One such case is *Geier v Hamer Enterprises*,

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Inc., 226 Ill App 3d 372, 589 N.E.3d 711 (1st Dist. 5th Div. 1992).

This is a minority opinion, but since many court cases are like playing roulette, there is no telling what the outcome may be.

It is important to understand that whenever a contractor agrees to add an owner and its executives, employees, and others as additional insureds and the endorsement issued does not reflect that requirement, the contractor may be confronted with a situation of having to pay for defense costs out of its own pocket. The reason is that the failure to procure a required coverage is not the subject of insurance, and certainly not considered as contractual liability—contrary to what some people may think.

So far, contractors and others who have not fulfilled their additional insured requirements are fortunate, in light of the absence of any cases holding them to their promises and adding executives and employees as insureds. But they are playing with fire. Contractors fear they will not get the job if they do not meet the contract requirements. However, it is so much easier to ask for that added coverage and to inform the owner when that requirement cannot be fulfilled than to act as if these requirements are automatically fulfilled. Sometimes owners will back off from such unrealistic requests.

In the final analysis, it is wise not to agree to additional insured status covering every one of the entity's personnel when it is not possible to do so. It could end up where the contractor's payout in defense costs and indemnification may be more than the contract was worth. It also behooves owners and others who request additional insured status for the entity and its personnel to check the endorsement at the time of issuance and deal with it then. It may be a lot cheaper in the long run for them, too. ■

Underwriting Trends is published four times a year by and for the members of the Underwriting Interest Group of the CPCU Society. http://underwriting.cpcusociety.org

Underwriting Interest Group Chairman
J. Brian Murphy, CPCU, ARM, ARe, AMIM
Brokers Risk Placement Services
E-mail: murphyb@brps.com

***Underwriting Trends* Co-Editor**
Gregory J. Massey, CPCU, CIC, CRM, ARM, PMP
Selective Insurance Company
E-mail: greg.massey@selective.com

***Underwriting Trends* Co-Editor**
Stephen W. White, CPCU
State Farm Group
E-mail: steve.white.bnbg@statefarm.com

Director of Technical Programming and Chapter/Interest Groups
John Kelly, CPCU
CPCU Society

Managing Editor
Michele A. Ianetti, AIT
CPCU Society

Production Editor/Design
Joan A. Satchell
CPCU Society

CPCU Society
720 Providence Road
Malvern, PA 19355
(800) 932-CPCU
www.cpcusociety.org

CPCU Society
720 Providence Road
Malvern, PA 19355
www.cpcusociety.org

Underwriting Trends
Volume 20 Number 1 March 2008